

# ANALYSIS OF AMENDED BILL

## Franchise Tax Board

Author: Rod Pacheco Analyst: LuAnna Hass Bill Number: AB 1222  
Related Bills: See Legislative History Telephone: 845-7478 Amended Date: April 2, 2001  
Attorney: Patrick Kusiak Sponsor: \_\_\_\_\_

**SUBJECT:** Dependent Exemption Increase

### SUMMARY

This bill would increase the dependent exemption credit.

### SUMMARY OF AMENDMENTS

The April 2, 2001, amendments removed all of the bill's provisions, which related to a credit for taxpayers that receive retired pay from active service as a member of the U.S. armed forces, and replaced them with the provisions discussed in this analysis.

### PURPOSE OF THE BILL

It appears the purpose of this bill is to increase the state dependent exemption credit incrementally until it is equivalent to the federal child tax credit.

### EFFECTIVE/OPERATIVE DATE

This bill is a tax levy and would become effective immediately upon enactment and operative for taxable years beginning on or after January 1, 2001.

### POSITION

Pending.

### ANALYSIS

#### FEDERAL/STATE LAW

Existing federal law allows a child tax credit of \$500 for each dependent child under the age of 17.

Federal law also provides various personal and dependent exemptions that are subject to income limitations. These exemptions are treated as deductions from adjusted gross income (AGI). The exemption amounts are indexed annually for inflation. The personal exemption amount is \$2,800 for the 2000 tax year. Exemptions begin to phase out at federal AGI levels over specified amounts.

#### Board Position:

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#### Department Director

#### Date

Gerald H. Goldberg

4/19/01

State law provides various exemption credits, including a personal exemption credit and exemption credits for dependents, blind persons, and individuals 65 or older. Unlike federal law, these exemptions are not deductions from AGI but are credits against tax. The amount of exemption credits for the 2000 tax year is \$235 for the dependent credit and \$75 for all other exemption credits.

The exemption credit amounts are indexed annually for inflation. The exemption credits are not refundable and may not be carried over to future years. Exemption credits begin to phase out at federal AGI levels in excess of the amounts listed below:

Filing Status	AGI (2000)
Single/Married Filing Separate	\$124,246
Head of Household	\$186,370
Married Filing Joint/Qualifying Widow(er)	\$248,494

The exemption credit amount is reduced by \$6 for every \$2,500 (\$1,250 for married filing a separate return) that the taxpayer's federal AGI exceeds the above threshold amounts, not to exceed 100%. Taxpayers that file a joint return or as a surviving spouse must reduce their credit by \$12 for every \$2,500.

Under existing federal and state law, individuals with gross income and AGI below the applicable filing thresholds are not required to file an income tax return since the standard deduction and personal exemption or exemption credit would result in zero tax liability.

### THIS BILL

This bill would increase the dependent exemption credit amount as follows:

- \$235 for taxable years beginning on or after January 1, 2000, and before January 1, 2001,
- \$282 for taxable years beginning on or after January 1, 2001, and before January 1, 2002,
- \$337 for taxable years beginning on or after January 1, 2002, and before January 1, 2003,
- \$392 for taxable years beginning on or after January 1, 2003, and before January 1, 2004,
- \$447 for taxable years beginning on or after January 1, 2004, and before January 1, 2005, and
- \$500 for taxable years beginning on or after January 1, 2005.

This bill would suspend the inflation adjustment of the dependent exemption credit for taxable years beginning on or after January 1, 2001, and before January 1, 2006.

This bill also would reduce the credit incrementally when California AGI exceeds specified threshold amounts. In the case of a single individual or a married individual filing a separate return, the phase-out is as follows:

<u>California AGI</u>	<u>Percentage of Credit</u>
Over \$128,459, and less than \$150,000	75%
Over \$150,001, and less than \$175,000	50%
Over \$175,001, and less than \$200,000	25%
Over \$200,001	0%

This bill also would provide similar phase-out tables with increased California AGI limitations for filing statuses of married filing joint or surviving spouse and head of household.

### IMPLEMENTATION CONSIDERATIONS

Existing law phases out the exemption credit amount incrementally when federal AGI exceeds a threshold amount. Further, existing law also requires the federal AGI threshold levels to be indexed annually for inflation. The added phase-out thresholds in this bill would create two different provisions in the law regarding the phase out of the dependent exemption credit, creating conflicting statutes and confusion for taxpayers. The author's staff has indicated that they would remove the bill's provision that phases out the credit.

### **LEGISLATIVE HISTORY**

AB 595 (Leach, 2001/2002) and SB 957 (Ackerman, 2001/2002) would increase the dependent exemption credit from \$235 to \$500. AB 595 is in Assembly Revenue and Taxation, and SB 957 is in Senate Revenue and Taxation.

SB 2114 (Leslie, 1999/00) and AB 2400 (Maddox, 1999/2000) would have increased the dependent exemption credit from \$227 to \$314. SB 2114 failed passage in the Senate Revenue and Taxation Committee, and AB 2400 failed passage in the Assembly Revenue and Taxation Committee.

AB 2797 (Stats. 1998, Ch. 322) increased the dependent exemption credit from \$120 to \$253 in 1998 and from \$222 to \$227 in 1999 and indexed the exemption credit for inflation beginning in 2000.

### **OTHER STATES' INFORMATION**

These states have the following dependent exemption amounts:

- *New York* has a dependent only exemption of \$1,000 per dependent.
- *Illinois* has a dependent exemption of \$1,650 per federal exemption.
- *Massachusetts* has a dependent only exemption of \$1,000 per dependent.
- *Michigan* has a dependent exemption of \$2,900 per federal exemption.
- *Minnesota* has a dependent exemption of \$2,800 per federal exemption.

These states were reviewed because of the similarities between California income tax laws and their tax laws.

### **FISCAL IMPACT**

This bill would not significantly impact the department's costs.

### **ECONOMIC IMPACT**

### TAX REVENUE ESTIMATE

Based on the data and assumptions below, revenue losses are estimated as follows:

Estimated Revenue Impact Taxable Years Beginning On or After January 1, 2001 Enactment Assumed After June 30, 2001 Fiscal Years (In Millions)			
	2001-2	2002-3	2003-4
Dependent Exemption Credit	-\$229	-\$448	-\$698

This analysis does not consider the possible changes in employment, personal income, or gross state product that could result from this measure.

### REVENUE ESTIMATE DISCUSSION

The impact of this bill would depend upon the number of taxpayers eligible to claim additional dependent exemption credits, the average credit claimed, and the average credit applied against tax liabilities.

This revenue estimate is based on the department's latest personal income tax model. This bill would benefit approximately 2.8 million taxpayers for the 2001 tax year. Approximately 96,000 currently taxable returns will become nontaxable in 2001 as a result of this bill. This estimate does not consider the phase-out amounts as suggested in this bill, since it is the intent of the author to amend the bill and remove this language.

### **LEGISLATIVE STAFF CONTACT**

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